

STATE OF INDIANA
OFFICE OF THE SECRETARY OF STATE
SECURITIES DIVISION

FILED
SECURITIES DIVISION

OCT 26 2010

INDIANA
SECRETARY OF STATE

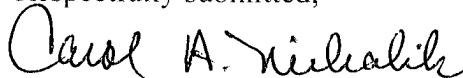
IN THE MATTER OF:)
)
DAVID KARANDOS,) Cause No. 10 – 0466 CD
)
Respondent.)
)

REQUEST FOR HEARING

The Office of the Indiana Secretary of State, Securities Division (the “Division”), has filed an Administrative Complaint against David Karandos (“Karandos”) alleging certain violations of the Indiana Securities Act, Ind. Code § 23-2-1-1 *et seq.* (“Act”).

The Enforcement Division respectfully requests this matter be set for a full evidentiary hearing no sooner than ninety (90) days from the date of this filing.

Respectfully submitted,



Carol A. Mihalik, Atty. No. 18793-29

Senior Counsel, Securities Division
Indiana Secretary of State, Todd Rokita
302 W. Washington St.
Government Center South
Indianapolis, IN 46204
(317) 232-6687

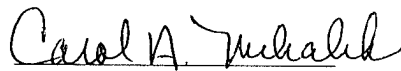
CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing complaint and request for hearing was served upon the following person(s) and counsel of record, via First Class United States Mail, postage prepaid, this 26th day of October, 2010.

David Karandos
11219 Fonthill Drive
Indianapolis, IN 46236

Steven Gomberg
Freeborn & Peters LLP
311 South Wacker Drive
Suite 3000
Chicago, IL 60606

Steven M. Malina
Greenburg Taurig LLP
77 West Wacker Drive
Suite 3100
Chicago, IL 60601


Carol A. Mihalik
Senior Counsel, Securities Division
Indiana Secretary of State, Todd Rokita
302 W. Washington St.
Government Center South
Indianapolis, IN 46204
camihalik@sos.IN.gov
(317) 232-6687

OCT 26 2010

INDIANA
SECRETARY OF STATE

STATE OF INDIANA
OFFICE OF THE SECRETARY OF STATE
SECURITIES DIVISION

IN THE MATTER OF:

DAVID KARANDOS,

the Respondent.

)
)
) Cause No. 10 – 0466 CD
)
)
)
)

ADMINISTRATIVE COMPLAINT

Introduction

The Office of the Indiana Secretary of State, Securities Division Enforcement Section (the “Division”), files this Administrative Complaint to provide notice and commence adjudicative proceedings against David Karandos (“the Respondent”) pursuant to the Indiana Securities Act, Ind. Code § 23-2-1 *et seq.* (2002) and Ind. Code § 23-19-1 *et seq.* (July 1, 2008) (“the Act”), and 710 Ind. Admin. Code § 1-19-1 *et seq.* (2007).

This is an enforcement action arising from multiple violations of state securities laws by the Respondent in connection with his employment at UBS Financial Services, Inc. (“UBS”) and Morgan Stanley, Inc. (“Morgan Stanley”), and the practices and fees relative to his client, the Indiana State Teachers Association (“ISTA”) and its various affiliate organizations. This complaint alleges violations of Indiana’s securities laws and regulations including Ind. Code § 23-2-1 *et seq.*, Ind. Code § 23-19-1 *et seq.*, 710 Ind. Admin. Code § 1-16-22, and 710 Ind. Admin. Code § 1-17-1.

Jurisdiction and Authority

1. The Securities Division is a division of the Office of the Secretary of State, with jurisdiction and regulatory authority in all matters relating to securities, as provided by the Act. The Act authorizes the Division to: 1) regulate the offer and/or sale of securities; 2) regulate those individuals offering and/or selling securities; and 3) conduct adjudicative proceedings to enforce the provisions of the Act and all Rules promulgated thereunder.
2. The Enforcement Section of the Division brings this action pursuant to the enforcement authority conferred by Ind. Code §§ 23-2-1-11 and 23-19-6, *et seq.* and 710 Admin. Code §§1-19, *et seq.* and 4-12, *et seq.*
3. The violations of law as averred took place in Indiana, and ultimately relate to an Indiana entity.
4. The Division reserves the right to amend this Administrative Complaint and/or file additional Administrative Complaints to reflect information developed during the pendency of the ongoing investigation.

Facts

5. The Respondent is registered as an investment adviser and agent under CRD #1934119. He served as ISTA's investment adviser representative, financial advisor and consultant for various accounts and entities, including the I.S.T.A. Insurance Trust ("IIT"), beginning in April, 1991. From 2003 to 2008, the

Respondent was a registered investment adviser and agent with UBS. Beginning in February, 2008 and continuing through the present time, the Respondent is a registered investment adviser and agent with Morgan Stanley.

6. UBS is a Delaware Corporation, with its principal office in the State of New Jersey, which does business in Indiana. CRD #8174. UBS' principal office in the state of Indiana is located in Marion County at 8888 Keystone Crossing, 10th Floor, Indianapolis, IN 46240. UBS served, with its employee David Karandos, as an investment adviser, financial adviser and consultant for various ISTA entities, including the IIT, until February 2008. UBS continued to manage and serve as custodian of certain IIT assets thereafter.
7. Morgan Stanley is a Delaware corporation, with its principal office in the State of New York, which does business in Indiana. Morgan Stanley's local office is located at 280 E. 96th St., Suite 300 in Indianapolis, IN. CRD #149777. Along with its employee David Karandos, Morgan Stanley served as an investment adviser, financial adviser and consultant for various ISTA entities, including the IIT, beginning in February 2008.
8. The Indiana State Teachers Association ("ISTA") is a labor organization that is comprised of several entities, including the ISTA, the NEA Properties, Inc.,¹ the Financial Services Corporation ("FSC"), the Administrative Services Corporation ("ASC"), the I.S.T.A. Insurance Trust ("IIT"), the Indiana Political Action Committee for Education ("I-PACE"), and the Welfare Benefits Plan & Trust ("WBPT").

¹ Previously the ISTA Center. A Certificate of Merger was filed September 9, 2009 with the Indiana Secretary of State identifying the entity now as NEA Properties, Inc.

9. The IIT, FSC, ASC and WBPT were components of the ISTA Financial Services Program (“FSP”).
10. The Financial Services Corporation is a for-profit, wholly-owned subsidiary of ISTA that, among other things, marketed financial products on behalf of the IIT.
11. The IIT was established by ISTA, and was charged with the design, implementation and management of various programs, including the health plan and the LTD plan, which the Indiana school corporations could then elect as benefit plans for their employees through the collective bargaining process.
12. The IIT’s health plan included a Claims Stabilization Reserve (“CSR”), which was purportedly invested on behalf of the individual school districts that were participating in the health plan.
13. The IIT’s Board of Trustees was staffed by the ISTA Executive Director, the ISTA President and the ISTA Treasurer, by virtue of their positions with ISTA, and by various other individuals, who were appointed by the ISTA President (collectively, the “Trustees.”) The Trustees, both appointed and *ex officio*, were typically teachers from various member districts. Neither financial knowledge nor investment experience was a prerequisite to being appointed as a trustee for either the IIT or the other ISTA boards.
14. The IIT was administered by nine trustees, the majority of whom were appointed by the ISTA President.
15. The IIT CEO was the named fiduciary of the Trust, and had the full authority to carry out all duties assigned to him by the Trustees. *See Exhibit A*, attached and incorporated by reference herein.

16. Included in those duties was the power to invest and reinvest the assets of the IIT fund and the power to enter into contracts on behalf of the IIT with respect to matters delegated to the CEO.
17. Warren Williams (“Williams”) served as the Executive Director of ISTA until his resignation in 2009. By virtue of his position with ISTA, Williams also served as a Trustee of the IIT. In addition, Williams was the self-appointed CEO for the IIT beginning in 2003. Accordingly, Williams had decision-making authority for the IIT the entire time that the Respondent served as the investment adviser, financial adviser and consultant to the IIT. More specifically, as IIT CEO, Williams was vested with all decision-making authority with regards to IIT investments beginning in 2003, and retained that authority until his resignation in 2009.
18. In April, 1991, the Trustees approved the Respondent, while employed by Merrill Lynch, as the Investment Manager for the IIT reserves.
19. Almost immediately, the Respondent began revising the IIT’s investment policy. In August, 1991, a letter from the Respondent was presented to the Trustees, which included three “recommendations for changes to the Investment Policy...” *See Exhibit B, attached and incorporated by reference herein.*
20. As early as 1995, the Respondent began recommending to the Trustees that the investment guidelines be changed, increasing the equity exposure range for the investments. His recommendation at that time was to increase the IIT’s equity exposure from the current 0% - 40% level to a level of 0% - 60%. The Respondent further recommended that the maturities on the investments be extended from a limit of five (5) years to a limit of ten (10) years.

21. In 1995, the Respondent also recommended that ISTA move various ISTA-affiliated accounts, *i.e.*, assets other than IIT assets, to his current employer, Merrill Lynch.
22. The Respondent was successful in cultivating a personal relationship with Williams. He met with Williams socially, introduced Williams to his current wife, and became Williams' personal investment adviser.
23. In December, 2002, the IIT CEO resigned. Williams, as the Executive Director of ISTA, appointed himself to the role of IIT CEO in February, 2003.
24. By virtue of his position as IIT CEO, Williams held the full authority to invest and reinvest the assets of the Trust and had the power to enter into contracts on behalf of the IIT with respect to matters related to the investment of IIT assets. Williams became the Respondent's primary contact with regards to the IIT's assets and investments.
25. The Respondent became a registered investment adviser representative with UBS in 2003. At that time alternative investments represented less than 10 percent of total investments for the IIT.
26. Although the Respondent also served as the investment adviser representative, financial adviser and consultant for other ISTA-affiliated accounts, only the IIT assets were invested in alternative, UBS proprietary products.
27. Upon information and belief, the Respondent was named as the "Investment Advisor," as that term was defined in Section 2.10 of the Trust Declaration, and specifically referenced in Section 5.3 of the Trust Declaration, and UBS was

named as the “Investment Manager” as defined in Section 2.11, and specifically referenced in Section 5.2 of the Trust Declaration.

28. The Respondent thereafter was a regular attendee at all IIT and other ISTA-affiliate board meetings.
29. In 2004, the Respondent prepared a Statement of Investment Policy (“2004 Policy”) for the IIT. That document provided that the IIT would have an Investment Management Consultant that would, *inter alia*, “...acknowledge in writing that they are a Fiduciary with regards to the services that they have been hired to perform.” See Exhibit C, attached and incorporated by reference herein.
30. The 2004 Policy was adopted by the Trustees on February 27, 2004, dated April 30, 2004, and executed by Williams on May 7, 2004.
31. The 2004 Policy provided that the IIT’s “assets shall be invested in accordance with sound investment practices that emphasize long-term investment fundamentals,” while concurrently recognizing that the IIT required liquidity in its investments, as it depended on its assets for operating income and to make benefit payments.
32. The 2004 Policy provided that investments in alternative products, including hedge funds and private equity funds, were to be limited to a maximum of 20% of the market value of the total portfolio.
33. Williams had the internal authority to implement the policy and to make investment and money manager decisions within the confines of the policy.
34. Any deviation from the 2004 Policy, or a change to that policy, was permitted only with the approval of the Trustees, and required that “the circumstances and

rationale for the change shall be documented and attached to this investment policy.”

35. There is no evidence to suggest that the Trustees approved any deviation from or change to the 2004 Policy.
36. Between 2004 and 2009, Williams relied on the Respondent to advise him with regards to various investment strategies.
37. Beginning in 2004, and continuing throughout his tenure at UBS, the Respondent repeatedly advised Williams to invest IIT monies in hedge funds and other alternative investments. Many of these investments consisted of UBS proprietary products, and were illiquid, non-transferable, and ineligible for sale on the secondary market.
38. The Respondent, during the same time period, also recommended to Williams that the IIT make substantial investments in private placements, in excess of the amount permitted in the 2004 Policy. These private placements were all UBS proprietary offerings, and as such were non-transferable and ineligible for sale on the secondary market, thereby making them highly illiquid.
39. Various communications reflect the Respondent was aware of cash flow problems within the IIT as early as February, 2007.
40. The proprietary investments were coupled with multiple placement fees and increased fees and commissions.
41. The purchase of the private equities also subjected the IIT to the potential for large future capital calls.

42. As early as August 2006, the Respondent directed that the alternative investments performance results be removed from composite reports regularly provided to the IIT.
43. In September, 2007, officials at ISTA questioned the Respondent regarding various investment trade articles as the topics pertained to the alternative investments of the IIT. The Respondent reassured ISTA that investing in alternatives is nothing new, and continued in his recommendations.
44. As of November 2007 the IIT had approximately 62%, or close to 20 million dollars of its portfolio, invested in alternative investment accounts.
45. An ISTA review of the investment statement in April 2008, after the Respondent left UBS, made note of inconsistencies among the reports provided to the IIT by the Respondent.
46. The Respondent began seeking alternative employment late in 2007.
47. The Respondent was hired by Morgan Stanley in February 2008.
48. As part of his hire package, the Respondent received a loan from Morgan Stanley in the amount of \$1,560,000, to be repaid by the Respondent over the subsequent nine (9) years.
49. Shortly after the Respondent transferred from UBS to Morgan Stanley, he solicited ISTA and the various ISTA entities, including the IIT, to encourage the transfer of their assets to Morgan Stanley.
50. The Respondent led Williams to believe that all of the IIT assets were transferable.

51. The Respondent recommended to Williams that the IIT enter into an Institutional Consulting Agreement with Morgan Stanley, which imposed a management fee, in lieu of a commission, based on a percentage of all IIT assets. In addition to the assets held at Morgan Stanley, the balance of IIT assets retained by UBS was also included in the performance-based management fee recommended by the Respondent.
52. UBS continued to charge the IIT a percentage fee, after the Respondent's departure, based on the value of the assets still under management at UBS, for managing and serving as custodian of the assets.
53. Due to the lack of transferability of the UBS proprietary products, the IIT was forced to accept approximately 40 cents on the dollar in order to exit the investments, as cash demands increased.
54. Late in 2008, as the value of the IIT portfolio was plummeting, the Respondent approached Williams seeking to have the original Institutional Consulting Agreement with the IIT amended, as pertained to his (the Respondent's) fees.
55. The Respondent explained to Williams that Morgan Stanley was not being paid for the assets under management at UBS, and that the original fee arrangement was no longer appropriate, given the amount of time and effort expended by him to assist in matters related to the illiquidity of, and the difficulty in the valuing of, products placed by him during his tenure at UBS.
56. The Respondent was aware that the IIT Trustees were not included in the fee negotiations between the Respondent and Williams, nor were they consulted prior to Williams' final decision to increase the Respondent's fees.

57. The fee arrangement was amended on November 5, 2008, by Williams, replacing the 1% performance-based advisory fee with an annual flat-dollar advisory fee of \$300,000, payable in advance in quarterly installments of \$75,000.
58. In April 2009, ISTA challenged excessive fee charges and instructed Morgan Stanley to reimburse the IIT in order to bring Morgan Stanley's and the Respondent's compensation in line with the parties' amended agreement.
59. In May, 2009, the Respondent was formally removed by Morgan Stanley as the investment adviser representative of all ISTA accounts, including the IIT accounts.
60. During both his tenure at UBS and Morgan Stanley, the Respondent was called upon on a regular basis by ISTA representatives to provide a suggested annual rate of return for the CSR funds invested by the IIT on behalf of various schools.
61. In many cases, the schools were then promised a guaranteed rate of return on their surplus CSR.
62. ISTA, by Edward Sullivan as Trustee of the IIT, filed a complaint in the Marion County Circuit Court, Cause No. 49D07-09-08-CT-040006. This suit lists UBS, Morgan Stanley and David Karandos, among others, as defendants, averring a breach of fiduciary responsibility.

Count I

63. The averments of paragraphs 1-62 are incorporated as if fully set forth herein.
64. Beginning in late 2003, the Respondent advised the IIT as to the development of the 2004 Investment Policy. The 2004 Policy recognized that the IIT required

liquidity in its investments, as it depended on its assets in order to meet its benefit obligations. The 2004 Policy provided, however, that investments in alternative products, including hedge funds, private equities and private placements, could be acquired in amounts up to a maximum of 20% of the value of the IIT's total assets.

65. As an investment professional, the Respondent should have known that a policy permitting 20% of IIT assets to be invested in highly illiquid alternative products was inappropriate for a benefit-funding trust such as the IIT. In developing and recommending an investment policy that permitted 20% of the IIT's assets to be invested in unsuitable alternative products, the Respondent engaged in acts that operated as a deceit upon the Trustees, in violation of Ind. Code §§ 23-2-1-12.1(a)(2) and 23-2-1-26(b)(2).
66. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). By developing an investment policy that allowed for significant investments that were unsuitable for the IIT, the Respondent engaged in dishonest or unethical practices, in violation of 710 IAC § 1-16-22(a)(1), 710 IAC § 1-16-22(b), 710 IAC § 1-17-1(c), 710 IAC § 1-17-1(w) and 710 IAC § 1-17-1(x).

Count II

67. The averments of paragraphs 1-66 are incorporated as if fully set forth herein.
68. Beginning in 2004 and continuing through 2007, the Respondent recommended to the IIT the purchase of unsuitable alternative investments, including hedge funds,

private equities and others. In so doing, the Respondent disregarded the IIT's stated objective of using its liquid assets to pay benefit obligations and operating expenses, and provided misleading representations regarding the expected performance of the investments, thus engaging in acts that operated as a deceit upon the Trustees, in violation of Ind. Code §§ 23-2-1-12.1(a)(2) and 23-2-1-26(b)(2).

69. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). By recommending to the IIT the placement of funds in alternative investment products that were misrepresented as suitable for the IIT, the Respondent engaged in unethical and dishonest practices, in violation of 710 IAC § 1-16-22(a)(1), 710 IAC § 1-16-22(b), 710 IAC § 1-17-1(c), 710 IAC § 1-17-1(w) and 710 IAC § 1-17-1(x).

Count III

70. The averments of paragraphs 1-69 are incorporated as if fully set forth herein.
71. Beginning in 2004 and continuing through 2007, the Respondent recommended, and the IIT acquired, numerous alternative investment products, including hedge funds, private equities and private placements. The majority of the investments recommended by the Respondent were products that were proprietary to UBS, having a commission structure that significantly benefitted the Respondent and UBS.

72. In recommending to the IIT the placement of funds in UBS proprietary products, the Respondent acted primarily to further his own and UBS' interests, as opposed to acting for the primary benefit of the IIT. The Respondent knew the fee structure associated with the UBS products; *i.e.* at the time of the placement UBS would receive a sizable up-front placement fee from the IIT in addition to a fee from the fund, and the Respondent would receive 40-42% of those fees. The failure to disclose this fee structure constitutes a deceit in violation of Ind. Code §§ 23-2-1-12(3), 23-2-1-12.1(a)(2) and 23-2-1-26(b)(2).
73. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). By recommending UBS proprietary products to the client, considering primarily the highly-beneficial fee structure rather than the cash flow needs of the client, the Respondent engaged in unethical and dishonest practices, in violation of 710 IAC § 1-16-22(a)(6)(C), 710 IAC § 1-16-22(b) and 710 IAC § 1-17-1(w).

Count IV

74. The averments of paragraphs 1-73 are incorporated as if fully set forth herein.
75. Beginning in 2004 and continuing through 2007, the Respondent recommended, and the IIT acquired, numerous alternative investment products, including hedge funds, private equities and private placements. The majority of the investments recommended by the Respondent were products that were proprietary to UBS.

76. Disregarding the IIT's stated objective of having sufficient liquid assets with which to pay operating expenses and benefit obligations, the Respondent recommended to the IIT products that were non-transferable and were unable to be sold on the secondary market, thereby making the products highly illiquid and consequently unsuitable for the needs of the IIT, in violation of Ind. Code §§ 23-2-1-12(3), 23-2-1-12.1(a)(2) and 23-2-1-26(b)(2).
77. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). By recommending the purchase of investments that were unsuitable to the IIT's stated objectives, the Respondent engaged in unethical and dishonest business practices, in violation of 710 IAC § 1-16-22(a)(1), 710 IAC § 1-16-22(b), 710 IAC § 1-17-1(c), 710 IAC § 1-17-1(w) and 710 IAC § 1-17-1(x).

Count V

78. The averments of paragraphs 1-77 are incorporated as if fully set forth herein.
79. By September, 2007, the Respondent had recommended, and the IIT had acquired, alternative investment products totaling over 55% of IIT assets. The 2004 Policy required that any deviation from or change to the 2004 Policy be documented in writing, signed by the Trustees, and attached to the original agreement. No such approval occurred.
80. By investing clients' funds, without the proper authority to do so, the Respondent engaged in a course of business that operated as a deceit upon the Trustees, in violation of Ind. Code §§ 23-2-1-12(3), 23-2-1-12.1(a)(2) and 23-2-1-26(b)(2).

81. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). While continuing to place IIT monies in alternative investments, in violation of the 2004 Policy, the Respondent engaged in unethical and dishonest practices, in violation of 710 IAC § 1-16-22(a)(1), 710 IAC § 1-16-22(a)(2), 710 IAC § 1-16-22(b) and 710 IAC § 1-17-1(w).

Count VI

82. The averments of paragraphs 1-81 are incorporated as if fully set forth herein.
83. By November, 2007, the Respondent had recommended, and the IIT had acquired, alternative investment products totaling over 55% of IIT assets, the majority of which were UBS proprietary products. As early as 2006, the Respondent began manipulating his quarterly presentation to the client, removing the alternative investments so as to not distort the earnings on other investments, and/or relocating the alternatives within the reports so as to minimize the appearance of losses on the investments.
84. By manipulating the data in the quarterly reports presented to the Trustees, the Respondent provided false, misleading or deceptive representations in violation of Ind. Code §§ 23-2-1-12(3), 23-2-1-12.1(a)(2) and 23-2-1-26(b)(2).
85. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). Providing false, misleading or deceptive representations to the client is identified as an unethical and

dishonest practice in violation of 710 IAC § 1-16-22(b), 710 IAC § 1-17-1(c) and 710 IAC § 1-17-1(w).

Count VII

86. The averments of paragraphs 1-85 are incorporated as if fully set forth herein.
87. In February 2008, the Respondent began soliciting ISTA, and specifically Warren Williams with regards to the IIT, to transfer its assets to Morgan Stanley, where the Respondent was recently hired. During the solicitation process, the Respondent mislead Williams and the Trustees into believing that the IIT's assets, in their entirety, would transfer to Morgan Stanley. Such misleading statements are a violation of Ind. Code § 23-2-1-12.1(d).
88. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). Providing false, misleading or deceptive representations to the client is identified as an unethical and dishonest practice in violation of 710 IAC § 1-16-22(b), 710 IAC § 1-17-1(c) and 710 IAC § 1-17-1(w).

Count VIII

89. The averments of paragraphs 1-88 are incorporated as if fully set forth herein.
90. In February, 2008, the Respondent recommended to the IIT an Institutional Consulting Agreement, which set forth the fee structure for Morgan Stanley's

management of the IIT assets. This agreement imposed a 1% fee for the entirety of the ISTA Insurance IIT assets, including those which did not, for proprietary reasons, transfer to Morgan Stanley from UBS.

91. The imposition of this fee based on assets not under the management of Morgan Stanley was unreasonable in light of the level of sophistication of the client as to fees, and also as to the client's limited bargaining power, due to the presence of an array of financial stressors, at the time of the agreement. The imposition of an unreasonable fee under these circumstances is identified as a dishonest and unethical practice pursuant to 710 IAC § 1-16-22(a)(8).
92. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). By recommending and imposing an unreasonable fee, the Respondent engaged in dishonest or unethical practices, in violation of 710 IAC § 1-16-22(a)(8) and 710 IAC § 1-17-1(w).

Count IX

93. The averments of paragraphs 1-92 are incorporated as if fully set forth herein.
94. In February, 2008, the Respondent recommended to the IIT an Institutional Consulting Agreement, which set forth the fee structure for Morgan Stanley's management of the IIT assets. This agreement imposed a 1% fee for the entirety of the IIT assets, including those which did not, for proprietary reasons, transfer to Morgan Stanley from UBS. Concurrently, the IIT was being charged a fee by UBS for services related to those accounts that were retained by UBS.

95. When entering into a contract of this nature, the investment adviser representative is required to give notice to the client, in writing, that the compensation arrangement connected to the rendering of advice is in addition to compensation from the client for the services. The imposition of a duplicative fee for the same advisory services, without prior written notice to the client, is identified as a dishonest and unethical practice pursuant to 710 IAC § 1-16-22(a)(9)(A).
96. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). By recommending and imposing a fee of this nature, without prior written notice to the client, the Respondent engaged in dishonest or unethical practices, in violation of Ind. Code § 23-2-1-11(a)(6), 710 IAC § 1-16-22(a)(9)(A) and 710 IAC § 1-17-1(w).

Count X

97. The averments of paragraphs 1-96 are incorporated as if fully set forth herein.
98. In February, 2008, the Respondent recommended to the IIT an Institutional Consulting Agreement, which set forth the fee structure for Morgan Stanley's management of the IIT assets. This agreement imposed a 1% performance-based fee for the entirety of the IIT assets.
99. When an advisory fee based on the value of the client's assets is imposed, certain information must be disclosed to the client, in writing, regarding the calculation of the fee, the nature of any index used to measure the investment performance and

its impact on the fee, and the possibility of adverse investment incentives created by the fee arrangement. 710 IAC § 1-16-17(h).

100. The Respondent failed to make proper disclosures to the client as required by Ind. Code § 23-2-1-12.1(b)(1) and 710 IAC § 1-16-17(h).

Count XI

101. The averments of paragraphs 1-100 are incorporated as if fully set forth herein.
102. In late 2008, the Respondent recommended that the IIT enter into a new fee arrangement, which charged the IIT an annual advisory fee of \$300,000 payable, in advance, in quarterly installments of \$75,000.
103. The imposition of this advisory fee was unreasonable in light of the level of sophistication of the client as to fees, and also as to the client's limited bargaining power, due to the presence of an array of financial stressors, at the time of the increase. The imposition of an unreasonable advisory fee under these circumstances is identified as a dishonest and unethical practice pursuant to 710 IAC § 1-16-22(a)(8).
104. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). By recommending and imposing an unreasonable advisory fee, the Respondent engaged in dishonest or unethical practices, in violation of Ind. Code § 23-19-4-12(d)(13), 710 IAC § 1-16-22(a)(8), and 710 IAC § 1-17-1(w).

Count XII

105. The averments of paragraphs 1-104 are incorporated as if fully set forth herein.
106. In late 2008, the Respondent recommended that the IIT enter into a new fee arrangement, which charged the IIT an annual advisory fee of \$300,000 payable, in advance, in quarterly installments of \$75,000. The \$75,000 fee was collected, in advance, every three months.
107. The advisory fee was excessive and unreasonable in that the fees purportedly related to time and effort expended by the Respondent to assist in matters related to the illiquidity of, and the difficulty in the valuing of, proprietary products placed by him during his tenure at UBS. The Respondent had received income relative to the placement of these products while at UBS, making additional advisory fees on the non-transferable products excessive and unreasonable. The imposition of an unreasonable advisory fee under these circumstances is identified as a dishonest and unethical practice pursuant to 710 IAC § 1-16-22(a)(8).
108. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). By recommending and imposing an excessive and unreasonable advisory fee, the Respondent engaged in dishonest or unethical practices in violation of Ind. Code § 23-19-4-12(d)(13), 710 IAC § 1-16-22(a)(8), and 710 IAC § 1-17-1(w).

Count XIII

109. The averments of paragraphs 1-108 are incorporated as if fully set forth herein.

110. From 2003 through 2007, the Respondent provided investment advice to ISTA with regard to a suggested guaranteed rate of return for what has been alleged as an unlawful, unregistered security, in the form of CSR, in violation of Ind. Code § 23-2-1-12(3).²
111. By assisting ISTA in determining a guaranteed rate of return on an unauthorized and unlawful offer of an unregistered security, the Respondent engaged in an act which operates or would operate as a fraud or deceit. Such act is identified as a dishonest and unethical practice. 710 IAC § 1-16-22(b).
112. Investment adviser representatives are fiduciaries and have a duty to act primarily for the benefit of their clients. 710 IAC § 1-16-22(a). By collaborating with ISTA in the development and offer of unlawful, unregistered securities, the Respondent engaged in dishonest and unethical practices, in violation of Ind. Code § 23-2-1-12(3), 710 IAC § 1-16-22(b), and 710 IAC § 1-17-1(w).

Relief Requested

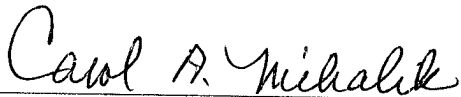
The aforementioned averments relate to specific violations of the Indiana Securities Act, giving rise to the Commissioner's authority, pursuant to Ind. Code § 23-19-6-4, to impose consequences upon the Respondent including, without limitations, fines, costs, restitution or disgorgement, and suspension or revocation of the Respondent's authority to do business in Indiana. The Enforcement Section of the Securities Division requests that the Commissioner take the following actions:

² See State of Indiana, ex rel. Chris Naylor, Indiana Securities Commissioner v. Indiana State Teachers Association, et al., Case No. 1:09-cv-1506-SEB-TAB.

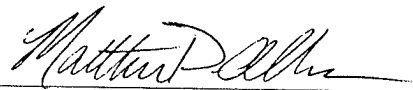
- a) Set this matter for hearing to find as fact the allegations as set forth in this Administrative Complaint and to;
- b) Find the violations of the securities law and regulations alleged herein have occurred and impose all appropriate consequences, including but not limited to, revocation or suspension of license, the full restitution of value of all investments, disgorgement of profits, fees and commissions, costs of the investigation, and fines;
- c) Find that all the sanctions and remedies detailed herein are in the public interest and necessary for the protection of Indiana investors and;
- d) Grant all other just and proper relief deemed appropriate.

Respectfully submitted,

INDIANA SECRETARY OF STATE
SECURITIES DIVISION



Carol Mihalik (#18793-29)
Senior Counsel
302 West Washington St., Room E-111
Indianapolis, IN 46204
317.232.6687 (phone)
317.233.3675 (fax)



Matthew D. Allen (#26676-49)
Enforcement Attorney
302 W. Washington St., Room E-111
Indianapolis, IN 46204
317.232.6683 (phone)
317.233.3675 (fax)